

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0650

Sales and Use Tax

For The Period: 1995 - 1997

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ISSUES

I. Sales and Use Tax: Repairing/Recutting Process

Authority: IC 6-2.5-5-4; Rotation Products Corp. v. Indiana Dept. of State Revenue, 690 N.E.2d 795 (Ind. Tax 1998); IC 6-2.5-5-3; IC 6-2.5-5-5.1

The taxpayer protests the assessment of tax on die repair equipment, materials and consumables.

STATEMENT OF FACTS

The taxpayer's business is twofold: (1) the taxpayer manufactures dies; and (2) the taxpayer "repairs/re-cuts" dies of its customers. The protest turns on whether the "die repair equipment, materials and consumables" used in the latter "repairing/recutting" process is tax exempt.

I. Sales and Use Tax: Repairing/Recutting Process

DISCUSSION

The taxpayer cites the case Rotation Products Corp. v. Indiana Dept. of State Revenue, 690 N.E.2d 795 (Ind. Tax 1998) as germane in the analysis of its repair/recutting process. Before examining Rotation Products, it will be useful to set out the applicable exemption statutes—namely, the so-called "industrial/manufacturing exemptions":

IC 6-2.5-5-3:

(b) Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for *direct use in the direct production, manufacture, fabrication,*

assembly . . . processing, refining, or finishing of other tangible personal property. (Emphasis added)

And the “consumption” exemption, IC 6-2.5-5-5.1:

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for *direct consumption as a material to be consumed in the direct production of other tangible personal property in the person’s business of manufacturing* (Emphasis added)

Turning to Rotation Products, the case involved a company that was “engaged in the repair and remanufacture of roller bearings” owned by Rotation’s customers. That is, Rotation’s customers (steel and paper mills) brought their unusable roller bearings to Rotation for “remanufacturing.” The Court held that,

Because RPC’s [Rotation] remanufacturing of roller bearings constitutes production within the meaning of the equipment exemption and the consumption exemption, the equipment and materials used in that process are exempt from sales and use taxes.

Id. at 805.

The Tax Court arrived at that holding by analyzing four factors: (1) the substantiality and complexity of the work done on the existing article and the physical changes to the existing article; (2) a comparison of the value of the article before and after the work on it; (3) the performance of the article versus that of new articles of the same kind; and (4) whether the work performed on the article is contemplated as part of the normal life cycle of the existing article. Id. at 803.

The question before the Department is the following: Is the taxpayer “remanufacturing” or is it simply repairing? The four-factor test outlined in Rotation Products is applicable to that question. And as the Tax Court noted in Rotation Products, the analysis of each factor will turn on a “fact sensitive inquiry.” Id. at 802.

The taxpayer argues that each of the four-factors is met:

- (1) Substantiality and complexity of the work done on the existing article and the physical changes to the existing article;

The taxpayer does not make an explicit argument with regard to the first factor. However the following quote from the taxpayer’s brief is relevant:

Diamond dies wear down and eventually lose their precise cut. . . . [W]hen a die loses its precise cut, it is sent back to [the taxpayer] for a recut.

[Further in the brief] The first step in the recutting process is cleaning the die with an ultrasonic cleaner to remove oils and lubricants. Then the die is inspected for any damage and to make sure that it can be recut to the new size desired. If the diamond is broken or there is not enough diamond left to enlarge the hole, the diamond can not be recut. ... [I]f recutable, the die goes to the wire machines in the finishing department. They undergo the same process as the new diamond does. The die is placed on a wire machine and a wire is drawn back and forth through the die to cut it to the new size desired. Diamond powder is placed on the wire to create the cutting process. The die is inspected with a microscope and a wire is pulled through to verify the hole size. The new die size is stamped on the die and old die size is removed.

According to the taxpayer, the manufacturing process (as opposed to the recutting/repairing process) involves the following:

Steel rod is cut to the desired size. A hole is drilled and a diamond is mounted in the hole. The die goes [to an out of state plant] where a laser machine cuts a hole in the diamond. The die is returned to [Indiana]. There the die is placed on a wire machine in the finishing department. Wire machines draw a wire back and forth through the die to cut it to the desired size. Diamond powder is placed on the wire to create the cutting process. The dies are then inspected with microscopes to ensure that they meet desired specifications. The die is stamped with a die size and shipped to the customer.

From the taxpayer's description of the recutting process and the manufacturing process, the recutting process tracks many of the steps of the manufacturing process (wire machinery is used, diamond powder, inspection, etc.). The taxpayer's recutting process seems to be as substantial and complex as the "grinding and polishing" that took place in Rotation Products.

The second factor:

- (2) A comparison of the value of the article before and after the work on it;

Taxpayer asserts that the diamond dies have no market value as diamond dies before the recutting. The taxpayer argues that an unusable product with little or no market is transformed into a marketable product

The third factor:

- (3) A comparison of the performance of the remanufactured article with the performance of a newly manufactured article of its kind;

Taxpayer argues that the recut diamond die is as good as a new diamond die, and the auditor agrees.

The final factor:

- (4) Is the work performed on the article contemplated as part of the normal life cycle of the existing article?;

The taxpayer argues that its customers do not know when they send their dies for recutting whether the dies can be salvaged at all (due to a broken diamond, or a diamond that is not big enough to allow an enlarged hole). Additionally, according to the taxpayer, “Normal repair would return the die to its original desired hole size. In this case, the recutting process produces a new die with a new hole size.” And further, the taxpayer states “Eventually, [the diamond die] can no longer be recut and becomes useless.”

The auditor notes that diamond dies are on average recut 6 to 8 times (though some dies can last up to twenty cuts). The auditor argues that when diamond dies are purchased it is anticipated that they will have to be recut.

The Tax Court states that fourth factor prevents “work that merely perpetuates existing products from qualifying for an industrial exemption.” *Id.* at 803. With regards to the facts of Rotation, the Tax Court noted that “grinding” cannot be seen as a “normal part” of a life cycle of a roller bearing. *Id.* at 803. Likewise, the recutting creates a *different* diamond die hole size, and thus the diamond die will not be the same as the original.

FINDING

Taxpayer’s protest is sustained.